

VAT ON ELECTRONIC SERVICES SUPPLIED TO EU CUSTOMERS

1. Introduction

On 1 July 2003, new VAT (Value Added Tax) rules with respect to electronically supplied services ('electronic services') will come into effect in the EU. On that date, EU Member States must have transposed into their national VAT legislation a EU Council Directive¹ relating to the supply of electronic services. Under the new rules, electronic services supplied to EU customers will be subject to VAT, even where the supplier is a non-EU business and the customer is a consumer. Until that date, electronic services supplied by non-EU businesses to EU consumers were free of VAT. The new arrangements will be applicable for a period of three years. New are the "single place of identification" arrangements, under which non-EU businesses may opt to be registered in a single Member State with respect to the supply of electronic services to consumers in the entire EU.

2. Electronic services

For the purposes of the VAT arrangement that come into effect on 1 July 2003, the concept of electronic services (or 'electronically supplied services') includes, *inter alia*, services that are listed in the new Annex L to the Sixth Directive. The non-exhaustive Annex L reads as follows:

- web site supply, web-hosting, distance maintenance of programmes and equipment;
- supply of software and updating thereof;
- supply of images, text and information and making databases available;
- supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events;
- supply of distance teaching.

Where the supplier of a service and his customer communicate via e-mail, this does not of itself mean that the service rendered is an electronic service.

Non-binding guidelines issued by the VAT Committee² have clarified the concept of electronic services. According to those guidelines, an "electronic service" is one that:

- is delivered over the Internet or similar electronic network; and

¹ Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services (OJ L 128, 15 May 2002). Although Member States must have transposed the provisions of that Directive into their national VAT legislation on 1 July 2003 at the latest, some Member States may fail to meet that deadline. In those circumstances, businesses may rely on the rules that should have been implemented, or on the national legislation, whichever benefits them most. Directive 77/388/EEC (the 'Sixth Directive') provides the legal framework for the imposition of VAT in the EU Member States. Each Member State levies VAT on the basis of a national VAT Act that must be in line with the Sixth Directive.

² The VAT Committee was set up under Art. 29 of the Sixth Directive to examine questions which concern the application of the provisions of that Directive in Member States, thus serving as a platform for an exchange of views in order to establish guidelines on uniform application concerning Community VAT provisions. The VAT Committee is made up of representatives from each of the 15 Member States, and is chaired by a representative of the European Commission. Since guidelines from the VAT Committee are not legally binding, they are not published by the Committee or the European Commission. Under the Rules of Procedure of the VAT Committee, Member States may publish agreed guidelines on specific matters. The guidelines on e-commerce have been published in the *International VAT Monitor* 3 (2003) p.

- the nature of which is heavily dependent on information technology for its supply i.e., the service is essentially automated, involving minimal human intervention and in the absence of information technology does not have viability.

More specifically this means that:

- radio and television programmes that are broadcast over the Internet or similar electronic network are electronic services. However, they cease to be electronic services where they are simultaneously broadcast over a traditional radio and television network (i.e., by wire or over the air, including by satellite).
- distance teaching is an electronic service when it is automated and dependent on the Internet or similar electronic network to function and its supply requires little or no human involvement. Where the Internet or similar electronic network is used as a tool simply for communication between the teacher and student (e.g., e-mail), this will not be viewed as an electronic service.
- where potential sellers obtain the right to list an item for sale on a website (e.g., an online market place) in exchange for a fee (e.g., a listing fee and/or a success fee), potential buyers bid for the item on the website via an automated process, the parties are notified by an automatically computer generated e-mail in the event of a completed sale and the buyer and the seller ultimately complete the sale, the service provided by the website operator (e.g., the operator of the online market place) is considered to be an electronic service. Such supplies may well constitute, at least in part, web-hosting services.

A more detailed list of services that are and are not considered as electronic services can be found in two annexes to the VAT Committee guidelines. Those annexes are reproduced in a separate box.

3. VAT regime for electronic services

As from 1 July 2003, different rules apply to electronic services supplied by EU and non-EU businesses. The VAT regime also depends on the (business or consumer) status of their EU customers. For the purposes of this article:

'EU businesses' are businesses that are established within the EU or have a fixed establishment³ there, through which they make supplies to EU customers,

'Non-EU businesses' are businesses that are established outside the EU and supply services from their place of business abroad,

'Consumers' means private individuals or non-taxable legal persons receiving supplies, and

'Recipient' means any person or entity that actually receives the supply.

3.1. *Electronic services supplied by EU businesses*

Electronic services supplied by EU businesses (or through EU fixed establishments of non-EU businesses) are not subject to VAT when the recipient is established or resident outside the EU.

Electronic services are taxable when the recipient is established or resident within the EU.

3.1.1. *EU recipient is a business*

³ The Community concept of 'fixed establishment' used for VAT purposes is similar, but not identical, to the OECD concept of 'permanent establishment' used for direct taxation purposes. Generally, a fixed establishment is a legally non-independent outlet, involving capital and human resources through which a non-established business carries out economic activities in the EU. For VAT purposes, fixed establishments of non-established businesses are treated as EU businesses.

Where the EU recipient is a business, VAT is due in the Member State where the recipient is established. When both the supplier and the recipient are established in the same Member State, the supplier must charge VAT on the invoice; when EU businesses supply electronic services to businesses established in another Member State, the recipients must account for VAT under the 'reverse charge mechanism'⁴.

3.1.2. EU recipient is a consumer

Where the EU recipient is a consumer, VAT is due in the Member State where the EU supplier is established or resident. EU suppliers must charge that VAT to those consumers and, therefore, do not need to be registered for VAT purposes in the recipient's Member State.

3.2. Electronic services supplied by non-EU businesses

Electronic services supplied by non-EU businesses are taxable where the recipient is established or resident within the EU. Regardless whether the EU recipient is a business or a consumer (i.e. a private individual or a non-taxable legal person) VAT is always due in the Member State where the recipient is established or resident.

3.2.1. EU recipient is a business

Where the EU recipient is a business, non-EU businesses supplying electronic services do not charge VAT on the invoice. Instead, the EU recipient must account for VAT on the received service under the reverse charge mechanism.

3.2.2. EU recipient is a consumer

Where the EU recipient is a consumer, non-EU suppliers must charge VAT to them at the rate that applies in the consumer's Member State⁵ and, therefore, must be registered for VAT purposes in that Member State. By consequence, non-EU businesses supplying electronic services to consumers that are resident or established in several Member States must be registered in each of those Member States. The number of Member States is presently 15 but will soon increase to 25⁶. However, under certain circumstances, non-EU businesses supplying electronic services to EU consumers are eligible for simplified registration arrangements. Under those arrangements, they only need to be registered in a single Member State with respect to supplies made to consumers established or resident in the entire EU, but they must still apply the VAT rate that is applicable in the consumer's Member State.

4. Single place of registration of non-EU suppliers

In order to avoid multiple registrations of non-EU businesses supplying electronic services to EU consumers, a special scheme was introduced that is based on the "single place of identification" principle.

4.1. Scope of the special scheme

The single place of identification arrangements are only available to non-EU businesses that supply electronic services from outside the EU to EU consumers on the condition that they are not engaged in other activities that would require them to be registered for VAT purposes in any of the Member States. Also non-EU

⁴ Generally, suppliers must charge VAT on goods and services to their customer. Under the reverse charge mechanism, suppliers do not charge VAT on the invoice. Instead, the customer must account for VAT on the goods or services received.

⁵ The VAT rates are listed in section 4.2

⁶ The present 15 Member States are listed in section 4.2 below. On 1 May 2004, the following 10 countries are expected to accede to the EU: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia.

businesses that are already registered, whether or not through a tax representative, in one of the Member States, or have a fixed establishment in the EU, are excluded from the special scheme.

Registration under the single place of identification arrangements is different from registration under the normal rules. Normally, registered businesses file periodic VAT returns through which they declare the VAT payable on taxable outputs and deduct VAT incurred on inputs ('input VAT'). On submission of each return, they only remit the balance to the tax authorities. However, non-EU businesses that are registered under the single place of identification arrangements, are not entitled to deduct input VAT through the VAT return in which they report VAT due on their outputs. Instead, they may recover such input VAT by filing separate refund applications under the procedure laid down in the Thirteenth Directive⁷. Under the Thirteenth Directive, non-registered, non-EU businesses may recover VAT on expenses incurred in EU Member States. They must submit annual or quarterly refund applications in the Member State where input VAT was paid. For the purposes of making refunds of VAT to non-established businesses, Member States are entitled to apply the reciprocity principle, which means that they only refund VAT to businesses that are established in countries that offer similar refund arrangements to EU businesses. With respect to refunds to non-EU businesses that are registered under the single place of identification arrangements, Member States may not apply the reciprocity principle.

4.2. VAT rates

Electronic services are subject to the standard VAT rate (unless they are exempt, for example online gambling). Under the single place of identification arrangements, non-EU suppliers must apply the standard VAT rate applicable in the Member State where the consumer is resident or established. Those standard rates –ranging from 15%-25%⁸– are the following:

Austria 20%	France 19.6%
Belgium 21%	Germany 16%
Denmark 25%	Greece 18%
Finland 22%	Ireland 21%

⁷ Thirteenth Council Directive of 17 November 1986 on the harmonization of the laws of the Member States relating to turnover taxes – Arrangements for the refund of VAT to taxable persons not established in the EU (86/550/EEC).

⁸ The variation in the applicable VAT rates may induce non-EU businesses to establish a fixed establishment in the EU, for example in Luxembourg. When they supply electronic services from that fixed establishment to consumers resident or established in other Member States, the Luxembourg VAT rate of 15% applies in all circumstances. When they supply electronic services from the place of business located outside the EU, non-EU businesses must apply 15%-25% depending on the Member State where the consumer is resident or established.

Italy 20%
Luxembourg 15%
Netherlands 19%
Portugal 19%

Spain 16%
Sweden 25%
United Kingdom 17.5%

4.3. Administrative procedure

Under the single place of identification arrangements, non-EU businesses must first select a Member State where they want to be registered. US businesses will obviously have a preference for English speaking Member States, such as the UK and Ireland.

Non-EU businesses must state to the tax authorities of the Member State of identification when their taxable activities commence, cease or change to the extent that they no longer qualify for the special scheme. Such statement must be made electronically. The information that non-EU businesses must provide to the tax authorities includes the following: name, postal address, electronic addresses, including websites, national tax number, if any, and a statement that the person is not identified for VAT purposes within the Community. When those details change, the non-EU business must notify the tax authorities.

The tax authorities of the Member State of identification will identify the non-EU business by means of an individual identification number and will inform the non-EU business of that number by electronic means.

Once registered, non-EU businesses must submit quarterly VAT returns by electronic means whether or not electronic services have been supplied. The return must be submitted within 20 days of the end of the reporting period to which the return relates. That return must set out the identification number and, for each Member State of consumption where tax has become due, the total value, less value added tax, of supplies of electronic services for the reporting period and the total amount of VAT payable. The applicable tax rates and the total tax due must also be indicated. In principle, the return must be made in euro, however, Member States that have not adopted the euro (UK, Denmark and Sweden) may require the VAT return to be made in their national currencies.

If the supplies have been made in other currencies, the exchange rate valid for the last date of the reporting period must be used when completing the VAT return. The conversion must be made on the basis of the exchange rates published by the European Central Bank for that day, or, if there is no publication on that day, on the next day.

The VAT due must be paid when the return is submitted. Payment must be made to a bank account denominated in euro (or a different national currency), designated by the Member State of identification. With respect to VAT returns, the Sixth Directive does not permit that amounts are rounded off to the nearest whole monetary unit (e.g., euro) and, therefore, the exact amount of VAT must be reported and remitted⁹.

Where non-EU businesses have declared and remitted an amount of VAT to the Member State of Identification, who in turn distributed that amount to the Member States of Consumption, and the Member States of Consumption subsequently realise that the amount is too high, the latter will advise the Member State of Identification of the adjustment and send the overpayment directly to the non-EU business. Where a non-EU business remitted, in relation to the declaration, an overpayment of VAT, the

⁹ This rule is based on the non-binding guidelines from the VAT Committee, see note 4.

Member State of identification will return the overpaid amount directly to the non-EU business¹⁰.

Non-EU businesses must keep records of the transactions covered by this special scheme in sufficient detail to enable the tax administration of the Member States of consumption to determine that the VAT returns are correct. On request, those records must electronically be made available for inspection by the Member State of identification and the Member State of consumption. The records must be maintained for a period of 10 years from the end of the year when the transaction was carried out.

The Member State of identification will exclude non-EU businesses from the identification register if:

- (a) they notify that they no longer supply electronic services, or
- (b) it otherwise must be assumed that their taxable activities have ended, or
- (c) they no longer fulfil the requirements necessary to be allowed to use the special scheme, or
- (d) they persistently fail to comply with the rules concerning the special scheme.

Non-EU businesses may cease to qualify for registration under the single place of identification arrangements, at any time throughout a calendar quarter where any of the criteria for exclusion are satisfied. If they are deregistered, the non-EU businesses are required to submit any outstanding return up to the end of the calendar quarter in which they were deregistered. The requirement to submit this return has no effect on the requirement, if any, for the non-EU business to be registered under the normal procedures in Member States immediately following their exclusion from the special arrangements¹¹.

Examples

Some practical examples may clarify the implications of the new legislation.

Example 1

A US company that has no fixed establishment and is not otherwise registered for VAT purposes in the EU, renders electronic services to EU consumers resident in Belgium, France, Luxembourg, Sweden and the United Kingdom.

The company qualifies for registration under the single place of identification arrangements. On the assumption that the company opts for registration in Belgium, it must apply:

- 21% VAT on electronic services rendered to Belgian consumers;
- 19.6% VAT on electronic services rendered to French consumers;
- 15% VAT on electronic services rendered to Luxembourg consumers;
- 25% VAT on electronic services rendered to Swedish consumers; and
- 17.5% on electronic services rendered to UK consumers.

The quarterly return only includes the VAT due on electronic services rendered to consumers (private individuals and non-taxable legal persons) resident or established in Belgium, France, Luxembourg, Sweden and UK. VAT relating to electronic services rendered to registered businesses established in those Member

¹⁰ Those adjustments are based on the non-binding guidelines from the VAT Committee, see note 4.

¹¹ This paragraph is based on the non-binding guidelines from the VAT Committee, see note 4.

States must not be included in the return as the taxable recipients must account for VAT under the reverse charge mechanism on the services received from the US company.

Example 2

A US company has no fixed establishment in the EU but has been assigned a VAT number by means of direct registration in the United Kingdom and a VAT number through a tax representative in France. That company renders electronic services to consumers resident or established in Belgium, France, Luxembourg, Sweden and the United Kingdom.

As the US company is already registered for VAT, it does not qualify for the single place of identification arrangements. Under the normal rules, the US company must obtain additional registrations in Belgium¹², Luxembourg¹³ and Sweden¹⁴.

The US company must file five separate VAT returns and pay VAT in each of those Member States at the rate of:

- 21% VAT on electronic services rendered to Belgian consumers;
- 19.6% VAT on electronic services rendered to French consumers;
- 15% VAT on electronic services rendered to Luxembourg consumers;
- 25% VAT on electronic services rendered to Swedish consumers; and
- 17.5% on electronic services rendered to UK consumers.

VAT relating to electronic services rendered to registered businesses established in those Member States must not be included in the returns as the taxable recipients must account for VAT under the reverse charge mechanism on the services received from the US company.

Example 3

A US company that has fixed establishments in Belgium, Luxembourg and Sweden renders electronic services to consumers resident in those Member States and, in addition, France and the United Kingdom.

As the US company has fixed establishments in the EU, it does not qualify for the single place of identification arrangements.

3.1. Services supplied from the US

In the (theoretical¹⁵) situation the US company renders the electronic services from the US place of business, it must obtain additional registrations under the normal rules in France and the UK.

Five separate VAT returns must be filed in each of the following Member States:

- 21% VAT on electronic services rendered to Belgian consumers (the return must be filed by the fixed establishment¹⁶);

¹² Under Art. 55(1)-(3) of the Belgian VAT Code and Art. 1(1) of the Royal Decree No. 31 of 2 April 2002, the US company must appoint a tax representative in order to register for VAT in Belgium.

¹³ Under Art. 61(1)(1°) of the VAT Law, and the Decree of 21 December 1979, the US company must register directly for VAT and provide a guarantee.

¹⁴ Under Chapter 23, § 4 of the Swedish *Mervärdesskattelag*, the US company must appoint a tax representative in order to register for VAT.

¹⁵ This situation is 'theoretical' because a fixed establishment is normally used to serve local customers.

¹⁶ Some Member States take the view that non-established businesses making supplies from their place of business abroad on which they must pay VAT in the Member State where their

- 19.6% VAT on electronic services rendered to French consumers (the US company must file the VAT return in France);
- 15% VAT on electronic services rendered to Luxembourg consumers (the return must be filed by the fixed establishment)
- 25% VAT on electronic services rendered to Swedish consumers (the return must be filed by the fixed establishment and
- 17.5% on electronic services rendered to UK consumers (the US company must file a VAT return in the UK).

VAT relating to electronic services rendered to registered businesses established in those Member States should normally not be included in the returns as the taxable recipients must account for VAT under the reverse charge mechanism on the services received from the US company. However, where non-established businesses have a fixed establishment in a Member State, that Member State may require that supplies made to customers in that Member State are administratively channelled through the fixed establishment, even though it is not involved in the transaction. In those circumstances, the fixed establishment must issue invoices, including VAT, relating to the supplies directly made by the US company.

3.2. Services supplied through the fixed establishments

Electronic services rendered through the fixed establishment in Luxembourg to Belgian, French, Luxembourg, Swedish and UK consumers (and any other EU consumers) are subject to 15% Luxembourg VAT.

All above transactions must be reported in the VAT return that is submitted by the fixed establishment to the Luxembourg tax authorities.

Electronic services rendered through the fixed establishment in Sweden to Belgian, French, Luxembourg, Swedish and UK consumers (and any other EU consumers) are subject to 25% Swedish VAT.

All above transactions must be reported in the VAT return that is submitted by the fixed establishment to the Swedish tax authorities.

EXAMPLES OF SERVICES THAT ARE ELECTRONICALLY SUPPLIED SERVICES

Web site supply, web-hosting and distance maintenance of programmes and equipment

- Web-site hosting and web-page hosting
- Automated, on-line distance maintenance of programmes
- Remote systems administration
- On-line data warehousing (i.e., where specific data is stored and retrieved electronically)
- On-line supply of on-demand disc space

Software and updating thereof

- Accessing or downloading software (e.g., procurement/accountancy programmes, anti-virus software) plus updates
- Banner blockers (software to block banner adverts showing)
- Download drivers, such as software that interfaces PC with peripheral equipment (e.g., printers)

customers are resident or established, must administratively channel the supply through their fixed establishment in those Member States, even where that fixed establishment is not involved in the transaction. However, most Member States and the European Commission do not agree with that view: they take the view that the non-established supplier must be registered and file returns with respect to the supplies it makes from abroad.

- On-line automated installation of filters on web-sites
- On-line automated installation of firewalls

Images

- Accessing or downloading desktop themes
- Accessing or downloading photographic or pictorial images or screensavers
- The digitised content of books and other electronic-publications

Text and information

- Subscription to on-line newspaper and journals
- Web logs and website statistics
- On-line news, traffic information and weather reports
- On-line information generated automatically by software from specific data input by the customer, such as legal and financial data (e.g., continually updated stock market data)
- The provision of advertising space (e.g., banner ads on a web site/web page)

Making databases available

- Use of search engines and Internet directories

Music

- Accessing or downloading of music onto PCs, mobile phones, etc.
- Accessing or downloading of jingles, excerpts, ring tones or other sounds

Films

- Accessing or downloading of films

Broadcasts and events – political, cultural, artistic, sporting, scientific and entertainment

- Web-based broadcasting that is only provided over the Internet or similar electronic network and is not simultaneously broadcast over a traditional radio or television network
- **Games, including games of chance and gambling games**
- Downloads of games onto PCs, mobile phones, etc.
- Accessing automated on-line games which are dependent on the Internet, or other similar electronic networks, where players are remote from one another

Distance teaching

- Teaching that is automated and dependent on the Internet or similar electronic network to function, including virtual classrooms,
- Workbooks completed by pupil on-line and marked automatically, without human intervention

Other services

- On-line auction services (to the extent that they are not already considered to be web-hosting services) that are dependent on automated databases and data input by the customer requiring little or no human intervention (e.g., an on-line market place or on-line shopping portals),
- Internet Service Packages (ISPs) in which the telecommunications component is an ancillary and subordinate part (i.e., a package that goes beyond mere Internet access comprising various elements (e.g., content pages containing news, weather, travel information; games forums; web-hosting; access to chat-lines etc.))

EXAMPLES OF SERVICES THAT ARE NOT ELECTRONICALLY SUPPLIED SERVICES

Supplies of goods

- A supply of goods, where the order and processing is done electronically
- A supply of CD-ROMs, floppy discs and similar tangible media
- A supply of printed matter such as a books, newsletters, newspapers or journals
- A supply of CDs, audio cassettes
- A supply of video cassettes, DVDs
- A supply of games on a CD-ROM

Supplies of service that relies on substantial human intervention and the Internet or electronic network is only used as a means of communication

- A supply of services of lawyers and financial consultants, etc., who advise clients through e-mail
- A supply of interactive teaching services where the course content is delivered by a teacher over the Internet or an electronic network (i.e., via remote link)

Supplies of services that are not delivered over the Internet and rely on substantial human intervention

- A supply of physical repair services of computer equipment
- A supply of off-line data warehousing services
- A supply of advertising services, such as in newspapers, on posters and on television
- A supply of telephone helpdesk services
- A supply of teaching services involving correspondence courses such as postal courses
- A supply of conventional auctioneers' services reliant on direct human intervention, irrespective of how bids are made (e.g., in person, Internet or telephone), ***Supplies of a radio and television broadcasting service***
- A supply of a radio and television broadcasting service provided over the Internet or similar electronic network simultaneous to the same broadcast being provided over traditional radio or television network,
- ***Supplies of telecommunication services***
- A supply of videophone services (i.e., telephone services with a video component)
- A supply of access to the Internet and World Wide Web
- A supply of telephony (i.e., telephone service provided through the Internet)

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